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Postal and Regulatory Reform in Intermodal Competition

**Christian Jaag
Helmut Dietl**

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**Swiss Economics SE AG
Stampfenbachstrasse 142
CH-8006 Zürich**

T: +41 (0)44 500 56 20

F: +41 (0)44 500 56 21

**office@swiss-economics.ch
www.swiss-economics.ch**

1. Abstract

This paper argues that transforming the postal business model goes hand in hand with a transformation in the definition of universal service obligation. Whilst postal operators need to fully embrace the unique competitive space created by electronic substitution, at the intersection between the physical and digital, regulatory frameworks also must be adapted towards a technology-neutral definition of universal service.

2. Introduction

Since the end of the 1990s, mail volumes have declined in most industrialized countries. There seems to be no foreseeable end to this trend and the decrease will strongly affect the development of postal markets in the future. Finding an appropriate co-evolution of regulation and market development has become one of the primary challenges of postal reform – both from a strategic and regulatory perspective.

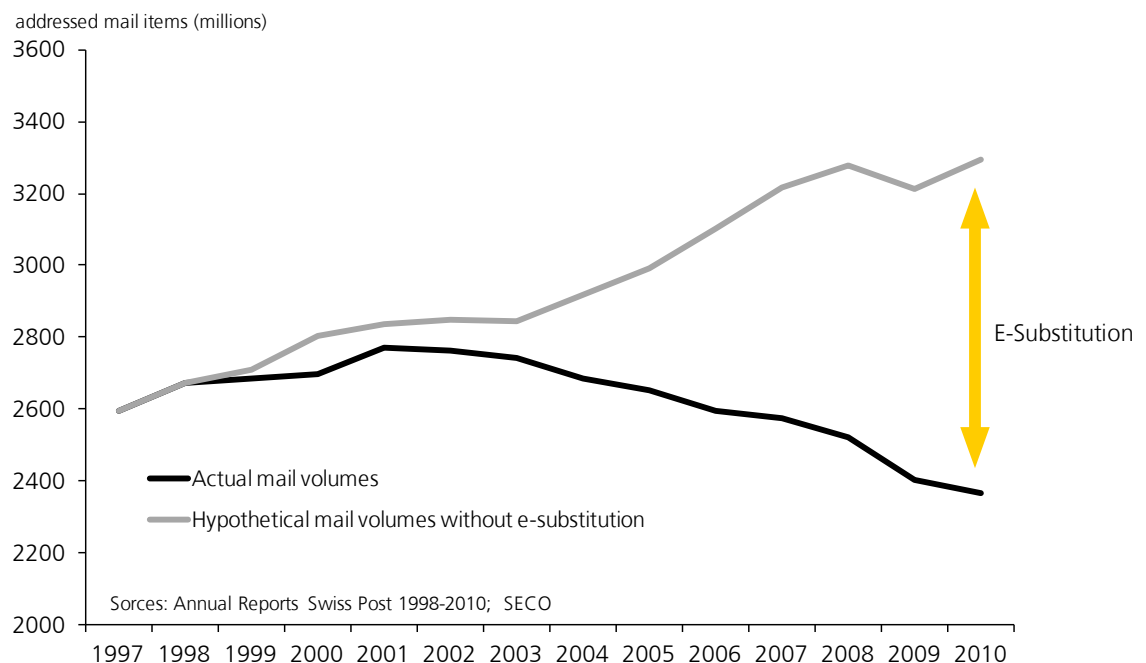


Figure 1: Addressed mail volumes in Switzerland 1997-2010.

Figure 1 compares actual addressed mail volume in Switzerland to hypothetical volumes based on GDP growth rates. Before the emergence of email, GDP and mail volumes used to grow at approximately the same rates. The reason for the recent decline is the increasing convergence of mail and telecommunication services¹. Telecommunication services seem to be almost perfect (and much cheaper)

¹ See Maegli et al. (2010).

substitutes for physical mail. Nevertheless, mail volumes per capita are still relatively high in many industrialized countries. In Switzerland, for example, there are still about 330 addressed mail items per year per person on average. If electronic means of communication are such good substitutes for physical mail why are there still such high mail volumes? Apparently, physical mail possesses qualities that are not rivaled by electronic communication².

Compared with electronic direct marketing, letter mail still offers a number of distinct benefits, such as the personal touch, a tactile experience and less intrusion. Moreover, letter mail, unlike electronic direct marketing, has a higher chance of being read when the recipient is more relaxed (e.g. after work or on weekends). These advantages enable postal operators to defend market shares in intermodal competition. They are also the basis for further developing the postal value proposition to their customers.

These observations raise two fundamental questions relating to the further development of postal markets:

- How can mail be positioned in the mid- and long-term as a valuable alternative to email (strategic perspective)?
- How can the increasing convergence of postal and telecommunications markets be mirrored by appropriate regulation – especially with respect to the definition of universal postal services (regulatory perspective)?

In the remainder of this paper, we will highlight some key issues related to these questions. The next section highlights strategic aspects and shows how postal operators can transform their business models in order to remain competitive. The following section addresses regulatory reform by analyzing how the definition of universal service obligations (USO) restrict or enable postal operators to transform their business models. Finally we provide some concluding remarks.

3. Postal strategy reform

To understand the strategic threat of declining mail volumes it is important to view postal services as a platform that connects two market sides, mailers on the one side and receivers on the other.³ The economics of this platform are characterized by strong (cross-side) network effects: Each additional receiver that is connected to the postal network increases the attractiveness of the network for mailers. Despite the fact that postal platforms create value for both market sides (i.e. mailers and receivers), only mailers are currently charged a price for these services. Receivers are subsidized.

When a competing platform, such as the internet, succeeds in attracting one side of this two-sided market, in this case the receivers, the cross-side effects decrease

² See Maegli and Jaag (2010).

³ See Jaag and Trinkner (2011).

and, in turn, the other side, in this case the mailers, have a strong incentive to also switch to the new platform. The result can be disastrous for postal operators.

How can postal operators react to these challenges? Basically, they have three options:

- Downsize their operations;
- Defend their core business through product and price differentiation as well as value-added services;
- Modify or even transform their business model and thereby react more aggressively.

Given the importance of network effects and the cost structure of postal operators (high fixed costs, low marginal costs), the first of the above options is not economically viable and may result in a vicious circle. The second option of defending the core business, consists of extending the existing value chain. This improves customer retention, spurs demand and thereby creates additional revenues.

For a more aggressive transformation strategy, there are basically three directions starting from the core business, as indicated in Figure 2. Operators can expand vertically, horizontally and/or geographically. According to the resource-based view of strategic management, the postal operator's strategy has to take the existing resources and capabilities into account. These comprise the postal network, access to every household (a valuable resource in times of crises such as a pandemic), brand reputation, trust, and delivery know-how. How can postal operators leverage these resources and capabilities?

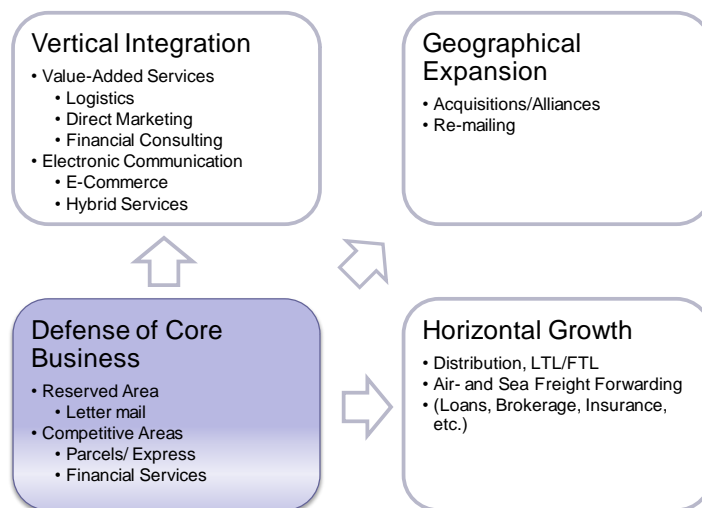


Figure 2: Business model transformation⁴

Swiss Post, for example, leverages its brand reputation and trust by offering new value propositions such as electronic certificates, encrypted or registered email, portable security and identification devices, and managed public key infrastructure services. The Post's unique selling proposition in comparison to other (so-

⁴ Adapted from Waller (2002).

cial) networks is its position as a trusted third party with verified data about its users. In contrast to Facebook or LinkedIn, for example, where the verification of postal addresses of users relies entirely on the users themselves, postal operators can guarantee that the published postal addresses are the actual addresses of users, and not made-up or intentionally fake ones.

4. Regulatory reform

The challenges to postal strategy lead to the question of how postal regulation affects such a modification and transformation of business models. Regulators determine the incentives and possibilities of business model transformation in the postal sector through a variety of regulatory instruments.

The introduction of reverse hybrid mail is a well known example of the interaction between regulation and postal innovation. Global warming has increased the cost of CO₂ emissions. As a result, in many places, printing and delivering postal items costs considerably more than giving away free e-readers such a Kindle or iPad. These revolutionary changes have to be taken into account when regulators define universal service obligations. Consider the following example from Switzerland: Swiss Post offers its customers the “Swiss Post Box” service. Whenever Swiss Post collects and sorts a letter addressed to the receiving customer, the envelope is scanned and emailed to the customer’s cell phone. The customer then has the options to have the letter opened and scanned, recycled, archived or delivered to the physical address. Hence, not all letter mail needs to be delivered physically and daily. The viability of this service depends on a technologically neutral formulation of the USO.

A technologically neutral USO means that the focus is on the satisfaction of consumer needs, not on the technology used to achieve it. For example, the main needs of recipients concerning postal services are physical and timely delivery. The technology used by the operator is of little interest. Reverse Hybrid Mail services, such as Swiss Post Box, improve physical delivery - they are the secure electronic complement to the physical mailbox. As a prerequisite for such a service, broadband and mobile penetration rates have to reach a critical mass. Then, universal services can become a technologically neutral multichannel concept which is built on the original idea of the USO: to safeguard the public’s access to a defined range of basic services. With the concept of a communications USO, no matter how quickly communication technologies change, the right to a minimum level of service quality is of high importance for the economic development of a society. Therefore, a unified definition of the universal service consists of the basic principle of having the possibility to communicate from senders to receivers irrespective of whether it is physical or electronic.

5. Conclusion

E-substitution and the resulting decrease in mail volume, forces postal operators to transform their business model. The combination of high fixed costs, low mar-

ginal costs, and significant (cross-side) network effects makes downsizing a dangerous response to these challenges. Besides defending their core business, postal operators can transform their business model. This transformation, which may include a vertical, horizontal or geographical expansion of the core business model, should take the existing resources and capabilities of postal operators into account. The existing network of post offices, access to all households, trust and reputation, are some of the most important assets of (incumbent) postal operators which can be leveraged by this business model transformation. Postal strategies, however, are strongly affected by postal regulations. The example of a technologically neutral USO highlights how regulators can encourage and facilitate the transformation of postal operators, without sacrificing their major social objectives.

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